

Message Text

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44

ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 CIAE-00 DODE-00 INR-10 NSAE-00

PA-03 RSC-01 USIA-15 PRS-01 ABF-01 L-03 H-03 EURE-00

AID-20 COME-00 EB-11 FRB-02 XMB-07 OPIC-12 CIEP-02

LAB-06 SIL-01 OMB-01 NSC-10 SS-15 STR-08 CEA-02 DRC-01

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P R 061753Z SEP 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 3827

INFO AMEMBASSY BONN

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

USMISSION OECD PARIS

USMISSION EC BRUSSELS

TREASURY DEPT WASHDC PRIORITY

C O N F I D E N T I A L LONDON 10246

DEPARTMENT PASS FRB

E.O. 11652; GDS

TAGS: EFIN, UK

SUBJECT: STERLING

BEGIN SUMMARY. CONTINUED DOWNWARD SLIDE OF STERLING
ATTRIBUTED TO DOMESTIC ECONOMIC UNCERTAINTIES, POOR
RESERVE FIGURES, AND ON THURSDAY, DELIBERATE SPECULATIVE
ATTACKS BY GERMAN BANKS. END SUMMARY.

1. STERLING HAS BEEN UNDER DOWNWARD PRESSURE ALL WEEK.
DOLLAR RATE FELL FROM \$2.4585 ON MONDAY TO \$2.38 ON
THURSDAY MORNING. WEIGHTED AVERAGE DEVALUATION AGAINST
MAJOR CURRENCIES FELL FROM 17 PERCENT ON MONDAY TO OVER
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19 PERCENT AT ONE POINT TODAY. FOREIGN EXCHANGE DEALERS

AT THE MAJOR UK AND US BANKS AND BANK OF ENGLAND OFFICIAL REPORT STERLING CAME UNDER HEAVY PRESSURE THURSDAY MORNING, SPARKED BY ORGANIZED SPECULATIVE ATTACK FROM GERMAN BANKS, WITH SOME SWISS BANKS ALSO JOINING IN. RUMORS ARE RIFE IN THE CITY THAT AIM OF SPECULATIVE PRESSURE HAS BEEN TO PUSH STERLING DOWN TOWARDS \$2.35. BANK OF ENGLAND HAS BEEN SUPPORTING RATE HEAVILY IN RANGE OF \$2.3950 TO \$2.40 IN ATTEMPT TO STABILIZE SITUATION. STERLING FELL TO \$2.38 THIS MORNING, RECOVERED TO \$2.4050 AT 3:00 P.M. AFTER BANK OF ENGLAND INTERVENTION.

2. FOREIGN EXCHANGE DEALERS ACKNOWLEDGE THAT MARKET DOES HAVE REAL ECONOMIC CONSIDERATIONS TO BE CONCERNED ABOUT. SPECIFICALLY CITED WERE UK NET RESERVE LOSSES OF \$385 MILLION IN JULY AND \$112 MILLION IN AUGUST. GROSS MAGNITUDE OF LOSS IN JULY AND AUGUST WAS IN RANGE \$1.1 BILLION, TAKING INTO ACCOUNT PUBLIC SECTOR BORROWING OF \$300 MILLION IN JULY AND \$290 MILLION IN AUGUST. TRADE FIGURES DUE NEXT WEEK ARE EXPECTED TO SHOW CONTINUED SIZEABLE DEFICIT. WHILE THIS IS TO BE EXPECTED WITH U.K. IN DEPTHS OF J CURVE, MARKET NONETHELESS NERVOUS.

3. ABOVE FACTORS, COUPLED WITH DOMESTIC ECONOMIC SITUATION WHICH INCLUDES PRIME MINISTER'S PROMISING TO PRESS FOR CONTINUED GROWTH, WHEN MANY OBSERVERS ARE ADVOCATING NEED FOR RESTRAINT, CULMINATES IN SITUATION WHEREBY DEALERS SAY IF MARKET HAD TO SPECULATE AGAINST SOME CURRENCY, STERLING HAS BEEN A GOOD TARGET.

4. SOME FEARS EXPRESSED BECAUSE OF POTENTIAL OUTFLOWS IF U.K. DOES NOT COME UP WITH SATISFACTORY RENEWAL OF STERLING AGREEMENTS DUE TO EXPIRE SEPTEMBER 24. IN RESPONSE, U.K. TODAY HAS MADE UNILATERAL ANNOUNCEMENT AIMED AT CONTINUED GUARANTEE OF HOLDINGS AT \$2.4213. (DETAILS SEPTEL.)

5. MILD FALL IN STERLING INTEREST RATES EARLY THIS WEEK AND TIGHT SITUATION IN GERMANY CITED AS AN INITIAL CONFIDENTIAL

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FACTOR IN OUTFLOWS. MARKET SOURCES CONSIDER FURTHER RISE IN U.K. INTEREST RATES MAY BE INEVITABLE, CITING IN PART HIGH INTEREST RATES EXPECTED IN GERMANY BETWEEN SEPTEMBER 10 THROUGH 20 BECAUSE OF CORPORATE TAX PAYMENT PERIOD. LONGER TERM, BANK OF ENGLAND SOURCE SEES NO POSSIBILITY OF FALL IN U.K. INTEREST RATES UNLESS U.S. AND EURODOLLAR RATES FALL TOO.

6. MARKET GENERALLY DESCRIBED AS UNSETTLED AND NERVOUS.
SPECULATION IN GOLD NOT REPEAT NOT CONSIDERED PART OF
CURRENT SITUATION. SOURCES ALL CONSIDERED THAT IMMEDIATE
OUTLOOK DOES NOT OFFER ANY UNDERLYING SIGNS OF RELIEF,
EXCEPT FOR WHATEVER COUNTERPRESSURE BANK OF ENGLAND WILL
SUPPLY AND POTENTIAL BENEFICIAL EFFECT OF EXTENSION OF
STERLING GUARANTEES.

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Message Attributes

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30 JUN 2005

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